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SECURITIES AND EXCHANGE COMMISSION

Staff Accounting Bulletin (SAB) No. 85 has been released by the SEC. SAB No. 85 expresses the staff's views relating to 1) use of the gross revenue method of amortizing capitalized costs of oil and gas properties by entities using the full cost method of accounting, and 2) the inclusion of methane gas within the definition of proved oil and gas reserves. The SEC staff said that while the effect of regulation on gas prices has lessened, factors other than price regulation have caused oil and gas prices to be disproportionate to their relative energy content. Therefore, the staff said it believes that it may be more appropriate for registrants to compute amortization based on the gross revenue method whenever oil and gas sales prices are disproportionate to their relative energy content to the extent that the use of the units of production method would result in an improper matching of the costs of oil and gas production against the related revenue received. Regarding the inclusion of methane gas within the definition of proved oil and gas reserves, the staff said it should be included in proved reserves, provided that it complies in all other respects with the definition of proved oil and gas reserves as specified in Rule 4-10(a)(2), including the requirement that methane production be economical at current prices, costs, and existing operating conditions. SAB No. 85 is expected to be published soon in the Federal Register. For further information after reading SAB No. 85, contact Robert F. Lavery at the SEC at 202/272-2130.

TREASURY, DEPARTMENT OF

The treatment of salvage and reinsurance under section 832(b)(5) of the Internal Revenue Code of 1986 is the subject of temporary and proposed regulations (see the 9/22/89 Fed. Reg., pp. 38979-87 and pp. 39000-01). The IRS said the regulations affect property and casualty insurance companies and provides them with guidance needed to comply with the relevant law. The regulations, according to the IRS, postpone the effective date of IRS' 1988 amendments to section 832(b)(5) published in the 1/5/88 Federal Register (see the 1/18/88 Wash. Rpt.). The effective date has been postponed until taxable years beginning after 12/31/88 and reinstate the prior regulations for taxable years beginning before 1/1/89. For taxable years beginning before 1/1/89, a taxpayer complying with the provisions of section 1.832-4T is deemed to have used a proper method of accounting for salvage. Written comments and requests for a public hearing must be delivered by 11/21/89. For further information after reading the temporary and proposed regulations, contact William L. Blagg at the IRS at 202/566-3294.

The use of certain corporate tax attributes under section 383 of the Internal Revenue Code of 1986 that are attributable to the period preceding an ownership change of the corporation are the subject of temporary and proposed regulations issued by the IRS (see the 9/20/89 Fed. Reg., pp. 38664-71 and pp. 38695-96). The IRS said section 383 of the Code was amended by the Tax Reform Act of 1986. The temporary regulations provide guidance under section 383 relating to the manner and method of absorbing the section 382 limitation with respect to certain capital losses and excess credits after there has been an ownership change of a corporation within the meaning of section 382, the Service said. Under section 382, the definition of "loss corporation" is amended to include a corporation which 1) is entitled to use a capital loss carryover, excess foreign taxes carried over under section 904(c), a carryforward of a general business credit under section 39, or a prior year's unused minimum tax credit under section 53; or 2) for a taxable year in which certain sales or other transactions relating to its stock occur has a net capital loss, excess foreign taxes under section 904(c), unused general business credits under section 38, or an unused minimum tax credit under section

53. The definition of "pre-change loss" is expanded to include "pre-change capital losses" and "pre-change credits." The temporary regulations are effective as of 9/19/89 and generally are applicable to any ownership change within the meaning of section 382 occurring after 12/31/86. Written comments and requests for a public hearing must be mailed by 11/20/89. For further information after reading the temporary and proposed regulations, contact Lori J. Jones at the IRS at 202/566-3205.

SPECIAL: SECTION 89 PROVISIONS REPEALED AND CIVIL TAX PENALTY SYSTEM SIMPLIFIED UNDER HOUSE BUDGET RECONCILIATION MEASURE; AICPA URGES ADOPTION

Repeal of most of section 89's complex testing rules and simplification of the civil tax penalty system are two of several provisions included in the budget reconciliation legislation which are of interest to CPAs and which are supported by the AICPA. The budget reconciliation measure includes these and other tax provisions approved by the House Ways and Means Committee and incorporated into the larger budget measure by the House Budget Committee. It is likely to be voted on by the full House in the near future. The tax package is supported by the AICPA, which has written CPAs identified as "key contacts" for members of the House of Representatives to request those CPAs to ask their House members to support the tax package.

While much of section 89, as enacted by the Tax Reform Act of 1986, would be repealed, certain non-discrimination rules would continue to apply to "executive only" health benefit plans and the health benefit plans of professional service organizations. Regarding simplification of the civil tax penalty system, the following changes would occur: "stacking" of penalties would be eliminated; the penalty for underpayment through negligence would be changed to 20 percent of underpayment directly attributable to negligence; fees for late filing information returns would be tied to how late they are; and the penalty for substantially understating tax liability would be reduced to 20 percent of the understatement.

Other important provisions include the following: 1) Simplification of the alternative minimum tax by eliminating the reference to book income items; 2) Clarification that the amount of any built-in gains tax paid by an S corporation reduces the amount of S Corporation income that is taxed to the S Corporation shareholders. Also clarifies that any minimum tax credit carryover of an S Corporation reduces any built-in gains tax of such corporation; and 3) Extension for two years of the 25 percent tax deduction for personal and family health insurance for self-employed business owners. The capital gains tax would also be modified by provisions of the budget reconciliation bill. Basically, a 30 percent exclusion would be provided from income of capital gains on the sale of assets between 9/14/89 and 12/31/91, with the gain not subject to the 33 percent bubble in the income tax rate. Also, for sale of assets acquired after 12/31/91, taxpayers would be allowed to index the basis of the asset for inflation occurring after 1991. While the AICPA has not adopted a policy position on the capital gains proposal, the Institute has previously issued policy statements supporting indexation of capital asset basis and preferable rates for capital gains.

Anti-estate freeze language is not included in the reconciliation measure. The AICPA has requested its members to urge members of Congress to include in the reconciliation legislation repeal of section 2036(c) of the Internal Revenue Code or deferral of it until Congress has explored the full impact of transfer taxes upon family businesses.

SPECIAL: AICPA TESTIFIES BEFORE ERISA ENFORCEMENT WORK GROUP ABOUT IG's REPORT ON PENSION PLAN SECURITY

"We don't know whether we're talking about a parking ticket or a case of hit-and-run," Joseph F. Moraglio, AICPA vice president for Federal government relations, said about alleged deficiencies of the quality of the audits of pension plans under ERISA. The alleged audit problems were cited in the Department of Labor (DOL) Inspector General's (IG) report on ERISA enforcement of private pension plans. The IG's report contains no indication of the significance of the alleged deficiencies, he stated. Mr. Moraglio made the statements while presenting testimony at a meeting of the ERISA Enforcement Work Group in Washington, D.C. He was accompanied by Ben B. Korbly, a member of the AICPA's Employee Benefit Plans Committee. The report, the IG's Semiannual Report to Congress for the period ending 3/31/89, advocated stricter standards and expanded responsibilities for independent public accountants (IPAs) and criticized the adequacy of the scope of the required audits in the enforcement of ERISA (see the 8/7/89 Wash. Rpt.). Mr. Moraglio also discussed several of the recommendations included in the IG's report--performing tests of compliance with ERISA, searching for all prohibited transactions, reporting directly to the DOL, imposing DOL sanctions on IPAs, and establishing an AICPA ERISA Practice Section. Regarding compliance testing, Mr. Moraglio said that if the Congress and DOL determine that it would be cost beneficial to have auditors test compliance with laws and regulations, the AICPA will work with DOL to develop necessary procedures that the auditor will apply in testing such compliance and in rendering the appropriate report in accordance with the AICPA's attestation standards. He also pointed out that any laws and regulations on which auditors would report in the context of a plan's operations must relate to financial matters within the competence of auditors to evaluate and there must be reasonable agreed-upon criteria to measure compliance. Mr. Moraglio also told the Work Group that the AICPA will work with DOL to provide additional guidance on planning the audit to detect prohibited transactions. Regarding reporting directly to DOL, he said any additional requirement for reporting directly to DOL should be imposed by DOL upon the plan administrators and not the independent auditors. Mr. Moraglio also noted that standards for IPA performance and appropriate sanctions are already established in Sections 103 and 104 of ERISA. In addition, Mr. Moraglio said, any alleged substandard work should be referred to the appropriate professional disciplinary bodies for action. He said the AICPA will report to DOL the findings the Institute discloses in every case referred to the AICPA. Establishing an AICPA ERISA Practice Section is not necessary, Mr. Moraglio told the group, because new AICPA quality review programs, which are already being implemented, will cover the auditing policies and procedures used by the entire firm. Therefore, he said, the objective of DOL will be achieved with the AICPA's present structure.

SPECIAL: FLORIDA SUPREME COURT TO CONSIDER PROHIBITING CERTAIN PENSION WORK NOW PERFORMED BY NON-LAWYERS; AICPA TO FILE BRIEF

CPAs and other professionals who are not lawyers would be prohibited from performing certain pension work under a Proposed Advisory Opinion submitted by the Florida Bar's Standing Committee on Unlicensed Practice of Law to the Supreme Court of Florida. In 1978 in The Florida Bar v. Turner, the Florida Supreme Court provided guidance on what constituted the unlicensed practice of law in the pension plan area. The Proposed Opinion attempts to define specific aspects of drafting and administering pension plans that do or do not constitute unlicensed practice of law if performed by someone other than a lawyer. Clarifying the scope of Turner is cited as one reason for submitting the Proposed Opinion; it states, "While attorneys tended to construe Turner in a restrictive manner, the certified public accountants, life insurance underwriters, enrolled actuaries and pension consultants practicing in this area read Turner more broadly." If adopted, the Advisory Opinion would prohibit CPAs from the following: 1) Drafting summary plan descriptions; 2) Advising an employer as to which options under a master and prototype plan are suitable for the employer; 3) Drafting plan documents at the request of the employer for review by the employer's counsel; and 4) Giving advice regarding the consequences or effects of the tax laws or other laws on a pension plan. The Proposed Opinion does recognize that ERISA and the Internal Revenue Code permit certain individuals who are not lawyers to perform certain functions, including the preparation of requests to the IRS for determinations as to qualification of the plan. The AICPA is working on a brief to be filed with the Florida Supreme Court on behalf of the profession, as is the Florida Institute of CPAs.

For further information contact Shirley Twillman at 202/737-6600.

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